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Supreme Court Reins In SEC's Disgorgement Power



This week the Supreme Court trimmed the SEC's power to seek disgorgement of unlawful gains by securities law violators by unanimously holding in [*Kokesh v. Securities and Exchange Commission*](#) that SEC disgorgement constitutes a penalty and such claims must be brought within five years of their accrual.

This decision resolved the circuit split described in a [previous post](#). **SEC Does Not Have Limitless Power to Impose Penalties** *Kokesh* involved the SEC's effort to collect \$34.9 million in disgorgement for conduct going back as far as 1995, and an additional \$18.1 million in prejudgment interest. The Court noted that statutes of limitations are "vital to the welfare of society" and set a fixed date when exposure to Government enforcement efforts end. The Court focused upon the nature of disgorgement and whether it constituted a "penalty" under the five-year statute of limitations in Section 2462 of Title 28 of United States Code. The Court found that disgorgement serves the same purpose of a penalty in that it too redresses a public wrong, rather than solely addressing harm to an individual. Individual victims, for instance, are not required parties to the action -- the SEC can bring the prosecution on behalf of the public interest. Moreover, like penalties, disgorgement is meant to punish and deter any would-be violators from committing similar offenses. Deterrence, the Court reasoned, is inherently punitive. Finally, the funds received from disgorgement are not compensatory; there is no statutory requirement for district courts to distribute disgorgement proceeds to victims. Rather, disgorged funds often end up going to the U.S. Treasury. As Justice Sonia Sotomayer wrote for the Court, disgorgement "bears all the hallmarks of a penalty: it is imposed as a consequence of violating a public law and is intended to deter, not to compensate." **Court Rejects SEC's Position** The Court rejected the SEC's argument that disgorgement is not punitive, but rather remedial because it restores the status quo. In fact, the disgorged amount sometimes exceeds ill-gotten gains resulting from the violation, and in some cases, is ordered without considering the expenses that offset any illicit profit. In such cases, the defendant is left worse off. The Court also noted that even if disgorgement serves compensatory goals in some cases, the fact that it also serves retributive or deterrent purposes makes it a punishment, bringing it within the statute of limitations like a penalty. **Court Includes An Interesting Footnote** In a footnote, the Court stated that nothing in the decision should be interpreted as an opinion on whether courts possess authority to order disgorgement in SEC enforcement proceedings or whether

courts have properly applied disgorgement principles in this context. No federal statute permits the SEC to seek disgorgement. Courts have ordered disgorgement pursuant to their inherent equity power. Whether the Court's footnote will spur future challenges to the SEC's efforts to seek disgorgement in enforcement actions remains to be seen. **SEC Defendants Benefit from Decision** The *Kokesh* decision is not a surprise. As we noted in our [previous post](#), the questioning during oral argument hinted at the Court's skepticism of the SEC's arguments. This ruling represents a significant victory for those in the SEC's crosshairs. For example, the *Kokesh* defendant's own disgorgement liability was sharply reduced from \$34.9 million to \$2.3 million. By limiting the SEC's power to seek disgorgement, individuals and entities who are the focus of the SEC's investigations and enforcement actions will now have more predictability regarding their potential financial exposure; they will now be able to more precisely account for legal fees and business costs associated with an SEC investigation. Moreover, no longer will those targeted by SEC investigations be subject to limitless investigations and monetary exposure for conduct going well beyond five years. The *Kokesh* opinion is a significant step toward balancing the SEC's important enforcement function with the rights of the accused.

Authors

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